

identified included the lack of fixed asset and associated records, maintenance of connectivity once it is established, technology plan approver control and requirements, insufficient documentation including lack of invoice detail and vendor payment information, incomplete or insufficient competitive bidding documentation, monitoring of technology plan goals and objectives, and physical security of equipment. Although the final report was released on April 23, 2003, USAC did not request policy guidance from Commission staff until October 2003. In January 2004, Commission staff provided "informal" guidance to USAC related to E-rate beneficiary audits being conducted by KPMG. These informal comments included reference to four (4) of the eleven (11) Arthur Anderson round 2 policy questions raised by USAC in their October 2003 request. On March 4, 2004, Commission staff provided guidance to USAC on the eleven (11) policy issues, almost two years after the draft report was submitted by Arthur Andersen. Many of the policy questions raised in USAC's request for guidance address issues identified in other audits including other E-rate beneficiary audits conducted by USAC's Internal Audit Division and those conducted by the FCC OIG.

Weaknesses in Program Competitive Procurement Requirements

Program rules require that applicants use a competitive procurement process to select vendors. In establishing this requirement, the Commission recognized that "(c)ompetitive bidding is the most efficient means for ensuring that eligible schools and libraries are informed about all of the choices available to them" and that "(a)bsent competitive bidding, prices charged to schools and libraries may be needlessly high, with the result that fewer eligible schools and libraries would be able to participate in the

program or the demand on universal service support mechanisms would be needlessly great.”

Applicants are required to submit a form 470 identifying the products and services needed to implement the technology plan. The form 470 is posted to the USAC web page to notify service providers that the applicant is seeking the products and services identified. Applicants must wait at least 28 days after the form 470 is posted to the web site and consider all bids they receive before selecting the service provider to provide the services desired. In addition, applicants must comply with all applicable state and local procurement rules and regulations and competitive bidding requirements. The form 470 cannot be completed by a service provider who will participate in the competitive process as a bidder and the applicant is responsible for ensuring an open, fair competitive process and selecting the most cost-effective provider of the desired services. Further, although no program rule establishes this requirement, applicants are encouraged by USAC to save all competing bids for services to be able to demonstrate that the bid chosen is the most cost-effective, with price being the primary consideration.

Although the programs competitive bidding requirements were intended to ensure that schools and libraries are informed about all of the choices available to them, we have observed numerous instances in which beneficiaries are not following the program’s competitive bidding requirements or are not able to demonstrate that competitive bidding requirements are being followed. We question whether the rules are adequate to ensure a competitive process is followed. In addition, weak recordkeeping requirements to support the procurement process, as well as other aspects of the E-rate application, offer

little protection to the program. We believe that the competitive procurement requirements are based on some faulty assumptions. For example,

- Form 470s will have enough information for meaningful proposals from prospective service providers.
- Service providers are reviewing and considering posted form 470s (particularly for smaller schools).
- “Applicable” state and local procurement regulations exist and those regulations are consistent with program rules.

Ineffective Use of Purchased Goods and Services

Site visits are conducted during most E-rate beneficiary audits. Site visits are conducted for several reasons including to evaluate the eligibility of facilities where equipment is installed, verify that equipment is installed and operational, and to verify that equipment is being used for its intended purpose. Examples of concerns identified during audits and investigations are as follows:

- Goods and services not being provided.
- Unauthorized substitution of goods and services.
- Goods and services being provided to ineligible facilities (e.g., non-instructional building including dormitories, cafeterias, and administrative facilities).
- Equipment not being installed or not operational. Program rules require that nonrecurring services be installed by a specified date. However, there is no specific

FCC rule requiring beneficiaries to use equipment in a particular way, or for a specified period of time, or to full efficiency. Commission staff have provided guidance stating that if the equipment was uninstalled (i.e., still in a box) that would represent a rule violation. However, Commission staff have also provided guidance stating that the rules do not require that beneficiaries effectively utilize the services provided or that the beneficiaries maintain continuous network or Internet connectivity once internal connections are installed.

Over-reliance on Certifications

The E-rate program is heavily reliant on applicant and service provider certifications. For example, on the form 470, applicants certify that the support received is conditional upon the ability of an applicant to secure access to all of the resources, including computers, training, software, maintenance, and electrical connections, necessary to use effectively the services that will be purchased under this mechanism. On the form 471, applicants make several important certifications. Applicants certify that they have "complied with all applicable state and local laws regarding procurement of services for which support is being sought" and that "the services that the applicant purchases ... will not be sold, resold, or transferred in consideration for money or any other thing of value." Other certifications are required on various program forms.

My office started to raise concerns about perceived weaknesses in the competitive procurement process and over reliance on certifications shortly after we became involved in program oversight. We first became concerned about the competitive procurement

process as a result of our involvement in the Metropolitan Regional Education Service Agency (MRESA) investigation. During that investigation we observed how weaknesses in competitive bidding requirements and reliance on self certification were exploited resulting in, at a minimum, a significant amount of wasteful spending. We continued to express our concerns as we designed our oversight program, developed a program for auditing beneficiaries, and supported E-rate fraud investigations. In fact, we established a working relationship with the Antitrust Division of the Department of Justice in a large part because of the number of investigations that we were supporting that involved allegations regarding the competitive procurement process.

Our level of concern regarding both the competitive procurement process and reliance on self-certification was heightened as we started to work with the Antitrust Division. During our discussions with Antitrust, they expressed a general concern with the lack of information regarding the competitive process and specific concerns regarding applicant and service provider certifications. We started to pursue issues raised by the Antitrust Division with Commission staff in the fall of 2002. I am pleased to report today that the Commission has addressed many of the recommendations from Antitrust and is considering action on other recommendations.

Weaknesses in Technology Planning

Program rules require that applicants prepare a technology plan and that the technology plan be approved. The approved technology plan is supposed to include a sufficient level of information to justify and validate the purpose of a request for E-rate funding. USAC

implementing procedures state that approved technology plans must establish the *connections between the information technology and the professional development* strategies, curriculum initiatives, and library objectives that will lead to improved education and library services. Although the technology plan is intended to serve as the basis for an application, we have observed many instances of non-compliance with program rules and USAC procedures related to the technology planning process. Examples of technology planning concerns identified during audits and investigations are as follows:

- Technology plans are not being reviewed and approved in accordance with program rules.
- Technology plans do not address all required plan elements in accordance with USAC implementing procedures for technology planning. Commission staff has provided guidance that failure to comply with USAC implementing procedures for technology plans is not a rule violation and does not warrant recovery of funds. As part of the current round of beneficiary audits, we are attempting to determine if USAC had the authority to establish these requirements.
- Applicants not being able to provide documentation to support the review and approval of technology plan.

USAC guidance on technology planning states that “(i)n the event of an audit, you may be required to produce a certification similar to the SLD sample "Technology Plan Certification Form," in order to document approval of your technology plan.” Numerous

audits have included findings beneficiaries were unable to provide documentation to *demonstrate the review and approval of technology plans*. Although program rules require that applicants have a technology plan and that the plan be approved, the rules do not require that the applicant maintain specific documentation regarding the approval process.

Discount Calculation and Payment of the Non-Discount Portion

The E-rate program allows eligible schools and libraries to receive telecommunications services, Internet access, and internal connections at discounted rates. Discounts range from 20% to 90% of the costs of eligible services, depending on the level of poverty and the urban/rural status of the population served, and are based on the percentage of students eligible for free and reduced lunches under the National School Lunch Program (NSLP) and other approved alternative methods. A number of audits have identified audit findings that applicants have not followed program requirements for discount rate calculation or were unable to support the discount rate calculated.

Applicants are required to pay the non-discount portion of the cost of the goods and services to their service providers and service providers are required to bill applicants for the non-discount portion. The discount rate calculation and program requirement for payment of the non-discount portion are intended to ensure that recipients avoid unnecessary and wasteful expenditures and encourage schools to seek the best pre-discount rate. Examples of concerns identified during audits and investigations are as follows:

- Applicant not paying the non-discount portion;
- Applicant not paying the non-discount portion in a timely manner; and
- Service providers not billing recipients for the non-discount portion.

I am pleased to report that concerns that we have raised about the E-rate program have received considerable attention at the Commission. Most notably, on August 4, 2004, the Commission adopted the Fifth Report and Order on the Schools and Libraries Universal Service Support Mechanism. In the Fifth Report and Order, the Commission resolved a number of issues arising from audits of the E-rate program and programmatic concerns raised by my office. In the introduction to the Fifth Report and Order, the Commission included the following statement regarding actions taken in the order:

First, we set forth a framework regarding what amounts should be recovered by the Universal Service Administrative Company (USAC or Administrator) and the Commission when funds have been disbursed in violation of specific statutory provisions and Commission rules. Second, we announce our policy regarding the timeframe in which USAC and the Commission will conduct audits or other investigations relating to use of E-rate funds. Third, we eliminate the current option to offset amounts disbursed in violation of the statute or a rule against other funding commitments. Fourth, we extend our red light rule previously adopted pursuant to the Debt Collection Improvement Act (DCIA) to bar beneficiaries or service providers from receiving additional benefits under the

schools and libraries program if they have failed to satisfy any outstanding obligation to repay monies into the fund. Fifth, we adopt a strengthened document retention requirement to enhance our ability to conduct all necessary oversight and provide a stronger enforcement tool for detecting statutory and rule violations. Sixth, we modify our current requirements regarding the timing, content and approval of technology plans. Seventh, we amend our beneficiary certification requirements to enhance our oversight and enforcement activities. Eighth, we direct USAC to submit a plan for timely audit resolution, and we delegate authority to the Chief of the Wireline Competition Bureau to resolve audit findings. Finally, we direct USAC to submit on an annual basis a list of all USAC administrative procedures to the Wireline Competition Bureau (Bureau) for review and further action, if necessary, to ensure that such procedures effectively serve our objective of preventing waste, fraud and abuse.

Update on OIG Oversight Activities

As I discussed earlier in this testimony, the primary obstacle to implementation of effective, independent oversight has been a lack of adequate resources to conduct audits and provide audit support to investigations. This lack of resources has prevented us from completing the body of work necessary to assess fraud, waste, and abuse at the program level.

Since our initial involvement in independent oversight of the USF as part of our conduct

of the FY 1999 financial statement audit, we have added four (4) staff auditor positions and organized USF oversight activities under an Assistant Inspector General for USF Oversight. This represents dedication of five (5) of the ten (10) auditors on the staff of the FCC OIG to USF oversight. In addition to the OIG staff dedicated to USF oversight, two (2) audit staff members responsible for financial audit are also involved in USF oversight as part of the financial statement audit process. In January 2005, we were advised that the OIG would receive two (2) additional staff for USF oversight. We are in the process of hiring these additional staff.

We have also requested appropriated funding to obtain contract support for our USF oversight activities. In our FY 2004 budget submission, we requested \$2 million for USF oversight. That request was increased to \$3 million in the President's budget submission for FY 2004. This funding was not included in the Commission's final budget for FY 2004 and report language indicated that monies for USF audits should come from the fund itself.

Based largely on that report language, we began to explore alternatives for obtaining access to contract audit support to implement the USF oversight portions of our audit plan. We have been working with USAC since last summer to establish a three-way contract under which the OIG and USAC can obtain audit resources to conduct USF audits. Under this contract, we intend to conduct the body of audits necessary to assess fraud, waste, and abuse at the program level by conducting a statistically valid sample of audits for each of the four USF funding mechanisms. The objectives of the audits are to:

(1) detect waste, fraud, and abuse by beneficiaries of the universal service support mechanisms, (2) deter waste, fraud, and abuse by beneficiaries of the universal service support mechanisms, (3) *generate insights about the compliance of beneficiaries with applicable law and the quality of administration of the universal service support mechanisms* and (4) identify areas for improvement in the compliance of beneficiaries with applicable law and in the administration of the universal service mechanisms. An additional objective is to identify improper payments as defined by the Office of Management and Budget to estimate error rates for the Improper Payments Improvement Act of 2002 (IPIA). I am pleased today to report that we are close to selecting a public accounting firm, or firms, to provide support for our USF oversight activities, including E-rate audits and support to E-rate investigations. We released a Request for Proposal in November 2004 and expect to complete the selection process very soon.

We are also working with USAC and a public accounting firm under contract to USAC to conduct the fourth large-scale audit of E-rate beneficiaries. One-hundred beneficiaries are being audited as part of this project. The project was initiated in August 2004 and is expected to be completed next summer.

Conclusion

The Office of Inspector General remains committed to meeting our responsibility for providing effective independent oversight of the USF and we believe we have made significant progress. While the Commission has taken steps to address programmatic

weaknesses, more work remains to be done. Through our participation in the fourth large-scale round of E-rate beneficiary audits with USAC and through audits that we anticipate conducting under our three-way agreement with USAC, we are moving forward to evaluate the state of the program and identify opportunities for programmatic improvements.